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ECONOMIC DEVELOPMENT AND CAPITAL ACCUMULATION: RECENT EXPERIENCE AND POLICY IMPLICATIONS

Interactive Thematic Session

14 June 2004 – Summary prepared by the UNCTAD secretariat

1. The session was based on presentations by a panel of experts, moderated by Enrique Iglesias (President, Inter-American Development Bank) and composed of Yilmaz Akyüz (University of Malaya, Kuala Lumpur), Martin Khor (Director, Third World Network), Guido Mantega (Minister of Planning, Brazil), Deepak Nayyar (Vice-Chancellor, University of Delhi), and José Antonio Ocampo (UN Under-Secretary-General for Economic and Social Affairs).

2. There was general agreement that, in the interplay of variables constituting a virtuous growth regime, capital accumulation occupied a central place. It was suggested that in Latin America more than 20 years of trade, financial and capital-account liberalization had failed to generate a process of sustained growth because these policies had not created the necessary investment dynamics. The recurrent crises in that region had resulted from structural weaknesses and excessive reliance on capital inflows requiring high domestic interest rates and leading to overvaluation and instability of exchange rates. As a consequence, growth had slowed considerably and become more erratic, and many countries had become dependent on the inflow of external capital. Developing countries in Asia had, on average, attained much higher rates of domestic capital accumulation. In these countries, macroeconomic conditions had been more favourable to increasing domestic investment in fixed capital. While there had been considerable diversity in the policies and strategies pursued by the more successful Asian economies, manufacturing exports had generally increased faster than imports, and export growth had resulted from increasingly competitive production for the most dynamic export products with high domestic value-added content. Real exchange rates had been kept at levels that supported the exports of domestic firms, and external financing requirements had remained limited.

3. With the adoption of the policy prescriptions of the "Washington consensus" in most Latin American countries, opening up to international competition had also been accompanied by deregulation and a general weakening of domestic economic policies in the context of market-friendly reforms. Macroeconomic policies in Latin America had generally been successful in bringing inflation under control and attracting foreign capital, but this had been at the expense of domestic capital

formation. To the extent that export success was achieved, it had been limited to a few sectors, mainly in commodity-based industries and in manufacturing with high import content, and it had not produced the overall structural change required for broad-based and sustained growth and development. Recently, prospects for Latin American growth and development had improved, partly because policies were now geared to providing more stimulus for the export sector. Indeed, a current-account surplus had been achieved, so that lower capital inflows were needed and debt-to-exports ratios were improving.

4. The panel also highlighted the experience of fast and sustained growth in India and China. It was suggested that the success of these economies could not be attributed to orthodox structural adjustment policies or greater openness. Rather, it was the result of initial conditions, characterized by a strong state, and well-sequenced liberalization in trade and finance. These experiences demonstrated the importance of coherent development strategies to cope with the challenges of globalization and the constraints resulting from existing rules for international trade and financial relations. However, it was acknowledged that the policy space to pursue such strategies was narrower in smaller economies and in countries operating under programmes with the international financial institutions.

5. Trade liberalization in East Asia had led to better results than in Latin America because it had been initiated after successful development of manufacturing industries, whereas in Latin America it had been a response to the failure of previous policies. The Latin American experience demonstrated that macroeconomic policies that focused too narrowly on the fight against inflation and attracting capital flows were unable to generate sufficiently high tares of domestic investment, and that investment in infrastructure and strengthening of domestic institutions were essential. While fiscal discipline was an important element in sound macroeconomic policies, the focus in macroeconomic management should not be on balanced budgets but on active measures to induce faster income and productivity growth and structural change, for which the development of local firms was considered more important than foreign direct investment (FDI).

6. It was suggested that, while interest rates and macroeconomic stability were crucial factors influencing the level of investment, microeconomic factors to improve the investment climate also mattered. It was necessary to avoid overregulation of economic activity and to ensure a legal and regulatory framework that favoured capital formation by domestic firms and the creation of new businesses in the most productive areas. Domestic financial markets had to be guided with a view to enhancing their contribution to higher investment in productive capacity rather than speculative financial activities. It was also necessary to use fiscal and monetary instruments to provide incentives for the reinvestment of profits and to discourage luxury consumption. In this context, it was recognized that not only the level of investment but also its allocation across economic sectors and activities mattered for its impact on development.

7. In general, globalization and liberalization had not led to greater income convergence between the North and the South. This was partly a result of the inappropriateness of uniform rules for unequal partners, and partly of a reduction of the policy space available to developing countries to promote industrialization and trade. Policy space had been reduced not only by World Trade Organization rules and conditionalities attached to international financial cooperation, but also by the integration of developing countries into international financial markets. It was therefore considered essential that developing countries use the remaining policy space more effectively, while it might also be necessary to revise existing rules, including in the context of multilateral trade negotiations, to enlarge this space. To achieve this, more democratic structures in global governance were considered necessary.

8. At the international level, innovative financing mechanisms should be explored, and countercyclical financing mechanisms should be strengthened. Remittance flows were considered an

increasingly important source of income for many developing countries, and it would be useful to explore mechanisms to ensure that such flows contributed more effectively to investment and growth.

9. There was also a consensus that the development of domestic industries should rely to a greater extent than in the past on domestic markets and increased regional and South-South cooperation. In order to have an impact on poverty reduction, policies for growth should go hand in hand with measures to ensure employment creation and social inclusion. The benefits of financing growth through external borrowing and FDI should be assessed more carefully. Given that economic conditions differed considerably across countries, there was a need for a greater diversity of approaches in the design of national development strategies.

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